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## Social capital, transition in agriculture, and economic organisation: a theoretical perspective

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# **DISCUSSION PAPER**

## **Institute of Agricultural Development in Central and Eastern Europe**

### **SOCIAL CAPITAL, TRANSITION IN AGRICULTURE, AND ECONOMIC ORGANISATION: A THEORETICAL PERSPECTIVE**

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**DISCUSSION PAPER No. 53  
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### ABSTRACT

Social capital is defined as the shared knowledge, trust, and culture, embodied in the structural forms of networks and other stable inter-agent relationships. Social capital has been shown to be more difficult to build than economic capital, and to have greater beneficial effects for community as a whole. The relevance of the social capital concept for transitional agenda is explained by the increasing responsibility of private collective action and grass-roots decisions in managing the business activities in agriculture, since this is required by the more democratic foundations of the market economy. Different forms of business organisations are shown to be differentially but consistently associated with social capital, with the major social capital dependent organisational form being the cooperative. The growing complexity of inter-agent relations (particularly in transitional context) causes the increasing amount of economic responsibility being transferred from authority-based to social capital-based forms of economic organisation, i.e. from markets and hierarchies, based mainly on economic capital, to networks with their primary accent on social capital. The social capital-based organisation in agriculture is particularly important in view of its industry-specific limitations and is represented mainly by cooperatives and farmers' associations. The optimal role of the government is to invest in social capital in order to enable rural communities to solve their problems by means of private collective action (self-organisation), rather than attempt to substitute the latter.

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Keywords: social capital, agricultural cooperative, economic organisation

### ZUSAMMENFASSUNG

Sozialkapital wird definiert als geteiltes Wissen, Vertrauen und gemeinsame Kultur, eingebettet in Netzwerkstrukturen und andere stabile Beziehungen zwischen Agenten. Es hat sich gezeigt, dass Sozialkapital schwieriger aufzubauen ist als ökonomisches Kapital und dass es größere Auswirkungen auf die Gemeinschaft als Ganzes hat. Die Relevanz des Sozialkapital-Konzeptes für die Agenda der Transformationsländer wird erklärt durch die wachsende Verantwortung von privaten, kollektiven Handlungen und Basisentscheidungen beim landwirtschaftlichen Betriebsmanagement, wie es für die demokratischen Strukturen der Marktwirtschaft erforderlich ist. Verschiedene Betriebsformen sind unterschiedlich, jedoch durchweg verbunden mit Sozialkapital. Die landwirtschaftlichen Produktionsgenossenschaften erweisen sich dabei als am meisten abhängig von Sozialkapital. Die wachsende Komplexität der Inter-Agenten-Beziehungen (insbesondere im Kontext des Transformationsprozesses) bewirkt, dass ein steigender Anteil ökonomischer Verantwortung von autoritätsbasierten zu sozialkapital-basierten Organisationsformen übergeht, d. h. von Märkten und Hierarchien, die vor allem auf ökonomischen Kapital basieren, zu Netzwerken mit dem Schwerpunkt auf Sozialkapital. Die sozialkapitalbasierten Organisationen in der Landwirtschaft werden hauptsächlich durch Genossenschaften und Bauernverbände repräsentiert und sind besonders wichtig in Hinblick auf ihre industriespezifischen Beschränkungen. Politische Maßnahmen sollten Investitionen in Sozialkapital unterstützen, um ländliche Gemeinden zu befähigen, ihre Probleme durch private, kollektive Handlungen (Selbstorganisation) zu lösen, anstatt zu versuchen, diese zu ersetzen.

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Schlüsselwörter: Sozialkapital, Agrargenossenschaft, ökonomische Organisation

### РЕЗЮМЕ

Социальный капитал определяется как совместно разделяемые знания, доверие, культура, структурно содержащиеся в сетях, ассоциациях, кооперативах и других устойчивых межсубъектных отношениях. В работе показано, что накопление социального капитала сопряжено с большими трудностями, чем в случае с экономическим капиталом, хотя в то же время социальный капитал имеет более существенные полезные эффекты для общества в целом. Актуальность социального капитала для переходных условий объясняется возрастающим значением «частных коллективных действий» и индивидуальных самостоятельных экономических решений в управлении сельскохозяйственным производством, что необходимо вытекает из демократических основ рыночной экономики. В работе показана закономерная связь между организационными отношениями некоторых форм хозяйствования и социальным капиталом, в частности также то, что наиболее зависимой от социального капитала формой организационной структурой является производственный кооператив. Возрастающая сложность межсубъектных отношений (особенно в переходных условиях) приводит к тому, что все больше экономической деятельности перемещается из организационных структур, основанных на ценовых отношениях и отношениях власти (соотв. рынков и иерархий) в структуры, основанные на социальном капитале. Организация, основанная на социальном капитале, имеет особое значение для сельского хозяйства в связи с его отраслевыми особенностями и представлена здесь кооперативными структурами и ассоциациями товаропроизводителей. Оптимальная роль государства состоит не столько в решении проблем товаропроизводителей, сколько в инвестировании в аграрный социальный капитал с целью обеспечить условия, при которых товаропроизводители посредством самоорганизации («частных коллективных действий») смогут самостоятельно решать свои социально-экономические проблемы.

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JEL: D23, P31

Ключевые слова: социальный капитал, сельскохозяйственный кооператив, экономическая организация

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**LIST OF ABBREVIATIONS**

APC	Agricultural producer cooperative
CEE	Central and East European
CEECs	Central and East European Countries

## 1 INTRODUCTION<sup>1</sup>

The rapidly growing and diverse literature on social capital is based on the recognition of social and economic processes as mutually determinative and penetrating. Economic performance of individuals, organisations, and communities is increasingly shown to be rooted not only and not so much in economic potential and managerial skills, but also in the existing sets of formal and informal institutions, stipulating the available choices and effective incentives. It is intuitively clear that as the social and economic interactions become more complex and diverse, the significance of the institutional framework should grow. In these conditions, it is increasingly important to ensure that the inter-agent relations are properly structured and organized; otherwise the accumulating transaction costs would inhibit the socio-economic processes.

Interdisciplinary approaches to economic development are particularly relevant to the study of transitional processes in the agricultural sector of Central and East European (CEE) countries. The transitional context provides a most telling evidence of social, cultural, political, psychological embeddedness of economic reality. The processes of organisational and structural change have been crucially dependent upon the values, norms, attitudes, and behaviours of the people who went through the transformation. The conclusion from here is that these intangible institutional components, generalized in the concept of social capital, are responsible for a significant share of transitional success, along with the economic potential and the quality of policy decisions.

The concept of social capital acquires still greater importance in view of the significant length of time required to build the basic institutional framework of a market economy. It means that the market solutions to many socio-economic problems will be either unavailable or unsatisfactory for a certain period. In this situation, social networks provide a mechanism of maintaining the functioning of society on a certain level of effectiveness (ROSE 2000). Moreover, as suggested by STIGLITZ (2000), even though a market economy may be relatively effective as a whole, specific markets may be imperfect, which causes some socially useful functions to remain undelivered. The existing social networks, connections, relationships, together with their moral and cultural foundations provide an important supplementing mechanism whereby the market relations are enhanced and socially optimized in the sense that the impersonality of market mechanism is compensated by various forms of social embeddedness related to the specific socio-economic conditions and cultural traditions of the society in question.

In view of these circumstances, the methodological implications of the social capital concept for theoretical interpretation of transitional processes are important and warrant special study. In this paper, an attempt is made to integrate the concept of social capital into the transitional context and to inquire into its possible implications for the organisation of economic activity. The objectives of the paper are to develop a methodologically balanced definition of social capital, disclose its distinctive features in relation to economic and human capital, substantiate the special relevance of the concept for the transitional context, and to introduce the concept of and to analyse the properties of the social capital-based economic organisation, as opposed to authority-based (hierarchy) and price-based (market).

The paper is organized as follows. In Sec. 2, the concept of social capital is methodologically substantiated and defined. Structural levels and distinctive properties of social capital are analysed. Sec. 3 demonstrates the significance of this phenomenon for the transitional condi-

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<sup>1</sup> The paper benefited from helpful comments by Alfons BALMANN, Jarmila CURTISS, Ulrich FIEGE, Martin PETRICK, Klaus REINSBERG, Peter WEINGARTEN, Axel WOLZ.

tions by emphasizing the growing role of private collective action for the successful completion of reform within the theoretical approaches of political economy, property rights, and transaction cost economics. In Sec. 4, the concept of social capital-based, opposed to authority- or market-based, economic organisation is introduced, its comparative properties are analysed, and possible forms of social capital-based organisation in agriculture are discussed. In Sec. 5, the policy implications of social capital concept are outlined. Sec. 6 contains some remarks on the normative implications of the concept of social capital. Concluding statements follow in Sec. 7.

## **2 THE CONCEPT OF SOCIAL CAPITAL**

The literature on social capital is at the same time far-reaching and self-critical. The growing number of specific applications of the concept has been matched by continual concerns whether it is relevant at all or contains any information that has not been known before the concept is applied. Hence, the theoretical foundations of social capital can hardly be considered to have been developed to the level of their more or less general recognition.

In this section, an attempt is made to explain the logic behind the emergence (and relevance) of the concept. To interpret social capital correctly, it is important to understand the factors that dictated a need in such a generalizing category. This task is undertaken in Sec. 2.1 by emphasizing a change in the basic role of inter-agent relations for the organisation of socio-economic reality. In Sec. 2.2, the major views of social capital are examined from a methodological perspective of its structural characteristics, and the methodological bases for a more comprehensive definition are developed in Sec. 2.3. In Sec. 2.4, some comparisons are made between social and the more traditional physical and human types of capital. The economic role of social capital as a resource allocation mechanism is the subject of Sec. 2.5.

### **2.1 The basic role of inter-agent relations**

The emergence of any new scientific concept or approach reflects the fact that the existing conceptual framework cannot effectively address and explain the phenomena being studied, either because the current framework has not been relevant with respect to the given epistemological objectives, or, in spite of this relevancy, the phenomenon is undergoing some significant changes. Such was the case, for example, with the emergence of institutionalist thinking in economic theory: neoclassical economic logic appeared to be only a part of the picture, with the other important parts accounting for social relations in their diverse forms, ranging from informal attitudes to legal and political regulations.

The concept of social capital seems to be at the same time a generalisation and refinement of the institutional approach, in that not only institutional structures, but inter-agent relations in general are understood as the relevant form of social embeddedness of economic reality. Not only the relations between individuals become an endogenous factor of economic analysis, but the economics itself becomes a part of the more comprehensive approach, according to which the economic reality occupies a specific place in the complex system of diverse social interactions.

As the very term ‘social capital’ implies, the integrative nature of the new approach lies in uniting the economic (‘capital’) and social aspects of inter-agent interaction. Although the relevance of the term and concept are debated in the literature, the upshot is that economic development is a result of a certain set of social relations, with this set of relations itself being subject to ‘economic engineering’, since the term ‘capital’ implies the possibility of investment and obtaining respective returns.

The term ‘social capital’ provides two important insights into the way the economic logic and social embeddedness are integrated. First, the ‘social’ component of the term makes explicit reference to the inter-agent relations as the building block whereupon the socio-economic building is built. Social capital is an essentially super-individual phenomenon, which seems to be recognized by every contributor to the field. SCHULLER et al. regard one of the key merits of the social capital concept to be the way “*it shifts the focus of analysis from the behaviour of individual agents to the pattern of relations among agents, social units, and institutions*” (2000, p. 35, emphasis in original).

Second, the ‘capital’ component implies that the inter-agent relations should be analysed from the perspective of costs and benefits. Inter-agent relations may generate streams of benefits for their participants, which are valuable and important for their utility maximisation. At the same time, these benefits are neither free nor is their mechanism of action obvious. The supply of these benefits requires costs, not only in the benefits per se, but also in the learning of how these benefits may be created.

The improvement of cost-benefit efficiency of inter-agent relations is a problem that can be regarded as universal and transtemporal for human history. Only recently, however, it has been expressly recognized and formulated in terms of the social capital concept. The very broad scope of the concept is reflected in the diversity of issues whereto the social capital approaches have been applied: macroeconomic development (FUKUYAMA 1995, KNACK and KEEFER 1997), labour markets (PETERSON et al. 2000, BUCK 2001), education (TEACHMAN et al. 1996, COLEMAN 1988, SUN 1999), criminal activity (HALPERN 2001, SAMPSON et al. 1997), health (WILKINSON 2002, BROWN and HARRIS 1978, KENNEDY et al. 1990), child welfare and lower rates of child abuse (COTE and HEALY 2001), government institutions (PUTNAM 1993, CUSACK 1999, SCHAFFT and BROWN 2000, PETRO 2001, LA PORTA et al. 1997). Although the specific contents and contexts of these issues are rather different, they share a common feature in that all of them crucially depend upon the ability of people to get along with each other, to take care of one another, to be mutually supportive and trustful.

Such fundamental setting of the problem may give rise to possibly skeptical questions concerning the reasons for emergence (or, rather, resurgence) of social capital theory at this time rather than another, taking into view the universal need of ensuring such cooperation (SCHULLER et al. 2000, LEMANN 1996). The answer can be related to the fact that the inter-agent relations are becoming increasingly complex, which means that the alternative outcome of social interaction are becoming increasingly diverse, even though the stock of resources underlying this interaction may be essentially the same<sup>2</sup>. Moreover, the progress of human society results in the growing power of conscious deliberate decision-making of the social groups in solving their problems. The further they develop, the more tools and mechanisms are available to them to organize the social action appropriately. In this perspective, *the emergence of interest in social capital is a self-explaining fact: it testifies that inter-agent relations have grown so complex that major resources of socio-economic development should be sought in them, rather than in technological or natural spheres*. To put it philosophically, the emergence of this concept marks a new stage in the continuous process of self-cognition of human society.

<sup>2</sup> MASKELL stresses the importance of social capital in globalisation processes, wherein the firms are placed ‘in a better position than their competitors to outsource and specialize still further, and to appropriate the excess rents flowing from the resulting deepening of the division of labour’ (2000, p. 117). Still another effect of globalisation is the reduced role of specific resource endowments, since additional resource from all over the world would be more readily available. This effect makes the role of local inter-agent relations more decisive.

## 2.2 The existing views of social capital: a classification

The existing views of social capital can be believed to vary in the dimensions concerned with the questions of who is its bearer and what is its specific contents, related to the particular standing of the bearer. In general, the thinking about social capital has evolved in the direction of expanding the scope of its bearers. In particular, OSTROM and AHN (2001) differentiate between minimalist, transitional, and expansionist view of social capital, according to which the concept is regarded in terms of individual connections, public good nature, and collective action.

SERAGELDIN and GROOTAERT (2000, p. 47) make a related attempt to discern between various organisational levels of social capital, but in a different way. They identify three views of social capital: 1) informal and local horizontal associations; 2) plus hierarchical associations; 3) plus formalized national structures such as government and the rule of law. In HALPERN's view (2001), social capital should be analysed in three levels: micro, including love, care, reciprocity, link to acquaintance and friends; meso, including networks between groups, neighbourhood and community; and macro, relating to norms, honours, diplomacy, and the role of the state.

In this study, the existing views of social capital will be classified according to the general structural levels of inter-agent relations: *individual, organisational, and community-level*. It is intuitively clear that the characteristics of social capital will vary with structural levels, in particular in the important respect of the relationship between costs and benefits of building it. It is important that although the cooperative and competitive aspects of social interaction are profoundly inter-related, social capital may promote one of them at the expense of the other<sup>3</sup>. It may be argued that the inverse relationship exists between the promotion of the relative competitive position of the agent and the structural level of social capital, which can be accessed by him, while the opposite relationship will be the case with the cooperative attitudes. In other words, more competition is associated with individual social capital, while more cooperation is characteristic for community-level one, whereas organisational social capital occupies an intermediate position.

It should be pointed out that the proposed classification is logical only and in this sense conditional: it is more based on the methodological characteristics of social capital rather than on the precise distinction among various contributors to the field, which means that views of some authors can pertain to several categories of the classification simultaneously.

The concept of individual-level social capital is typified by BURT in his interpretation of the latter as one's relationships with "friends, colleagues, and more general contacts" (1992, p. 9). This view was characteristic for the researchers who introduced the concept into contemporary theoretical discourse, in particular BOURDIEU (1986). In COLEMAN's characteristic of his predecessors, social capital is understood as "the set of resources that inhere in family relations and in community social organisation that are useful for the cognitive or social development of a child or young person. These resources differ for different persons and can constitute an important advantage for children and adolescents *in the development of their human capital*" (COLEMAN 1990, p. 300, emphasis added). Belonging to this category is also BURT's (1992) argument about structural holes, which defines social capital "in terms of the information and control advantages" which individuals use strategically. Hence, the benefits of social capital on individual level take the form of the privileged access to prestigious connections or

<sup>3</sup> Related to this point is recognition of the possible downside consequences of certain forms of social capital, indicated in the works of PORTES (1998), later PUTNAM (2000). However, the reasoning in this section draws on a different aspect of whether social capital promotes competitive or cooperative tendencies.

opportunities of better enhancement of individual human capital or material status, which is only possible at the expense of exclusion of everybody else.

The organisational level of social capital is probably least represented in the literature in the pure form. In the definition by OECD, social capital is “networks together with shared norms, values and understandings that facilitate cooperation within or among groups” (COTE and HEALY 2001, p. 41). Here, the intra- and inter-group cooperation are regarded as homogeneous, with no implication of the special importance of intra-group network externality effects. STIGLITZ, reviewing the possible implications of organisation theory for the social capital research, mentions that social capital is associated with tacit knowledge, collection of networks, aggregation of reputations, and “organisational capital that managers have developed through their styles of administration, incentives and command, their labor practices, hiring decisions, systems of dispute resolution, style of marketing, and so on” (2000, p. 61).

On the organisational level social capital can be said to generate network externalities, which imply both cooperation and exclusion, in that the organisation members should cooperate to enjoy the externality providing for their privileged status in relation to non-members which are, respectively, excluded. In COLEMAN’s words, “Social capital is defined by its function. It is not a single entity, but a variety of different entities, with two elements in common: they all consist of some aspect of social structure, and they facilitate certain actions, whether persons or corporate actors, *within the structure*” (1988, p. 98, emphasis added). In this definition, the concept of network externality is obviously implied, since the facilitation of action is restricted to group membership exclusively.<sup>4</sup>

However the concept of organisational social capital, based on the intra-group but not (necessarily) inter-group cooperation is methodologically present in the distinction between bridging and bonding social capital. Bridging social capital is associated with knowing people outside one’s immediate network, while bonding social capital presupposes communication within a well-delineated circle of family, close friends, colleagues, etc. (see e.g. PUTNAM 2000, p. 19). The differentiation between these two types of social capital is believed to be methodologically based on GRANOVETTER’s (1973) distinction between ‘strong’ and ‘weak ties’. The possible social costs of bonding capital are acknowledged (NARAYAN 1999).

The community-level social capital, conceptually introduced primarily by PUTNAM, seems to dominate the theoretical thinking of most contemporary studies of the concept. The purely cooperative essence with no implications of non-member excludability is obvious in the following definitions of social capital: “an instantiated informal norm that promotes cooperation between two or more individuals” (FUKUYAMA 2000, p. 4); “features of social organisation, such as trust, norms, and networks, that can improve the efficiency of society by facilitating coordinated action” (PUTNAM 1993, p. 167); “institutions, relationships, and norms that shape the quality and quantity of a society’s social interactions... Social capital is not just the sum of institutions which underpin a society – it is the glue that holds them together” (WORLD BANK (without year)); “networks, norms, and trust that enable participants to act together more effectively to pursue shared objectives” (PUTNAM 1996, p. 56); “features of social organisation, such as civic participation, norms of reciprocity and trust in others, that facilitate cooperation for mutual benefit” (KAWACHI et al. 1997). On community level the competitive relations can be said to be non-existent since nobody is intended to be excluded from the enjoyment of potential benefits of cooperation. The general problem in building the commu-

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<sup>4</sup> On the other hand, COLEMAN was concerned with the public good nature of social capital resulting in attenuated incentives to invest in it. However this is the collective action problem which in this study will be attributed to the community, rather than organisational, level of social capital.

nity-level of social capital is recognized as free-riding, the major problem of collective action (see OSTROM (1990, 1992); PUTNAM (2000); OSTROM and AHN (2001)).

A comparison of the indicated structural levels of social capital in terms of costs and benefits is attempted in Table 1. Here, the costs of organisational social capital, representing a mixture of attributes of social capital on individual and community levels, include the risk of ‘organisational lock-in’ whereby it is implied that an organisation able to generate network externalities to its members may not necessarily be beneficial in all respects. There may be also undesirable effects upon the participants, which are however outweighed by the positive effects of network externalities, otherwise the members might quit the organisation. Still, these negative externalities may persist as long as the positive externalities are more important.

**Table 1: The structural levels of social capital**

Level	Benefits	Costs
<b>Individual</b>	Privileged access to prestigious connections	Exclusion of everybody else
<b>Organisational</b>	Network externalities	Exclusion of non-members; organisational lock-in; free-riding
<b>Community</b>	Cooperative spill-over effects	Free-riding

Source: Own presentation.

The three structural levels can be thought as the evolutionary path of both thinking about social capital and social capital itself, reflecting the preferable direction of the socio-economic development. Society wins if the individual social capital is transformed into organisational one, and the latter – into community-level one. Moreover, there are no precise boundaries between them. When the connection, forming the basis of individual social capital gets sufficiently large and a larger number of members are eligible for it, the organisational social capital has arguably emerged. When the organisation or network gets so large that its internal relations become diffuse and cross-monitoring costly, collective action problems arise and community level social capital appears. The problem of evolution of social capital can be visualized as that of overcoming the respective costs. When the costs of certain level can be borne, there is nothing that would prevent the society from accumulating social capital on that level.

### 2.3 The problem of definition

As the preceding review of some of the definitions of social capital testifies, they are diverse, numerous, and revealing various important aspects of the concept. No definition of social capital seems to be generally accepted, so certain reconsideration of the concept in the light of the assumed research objectives seems expedient.

Most of the available definitions of the concept contain references to norms, values, relationships, connections, networks as the characteristic features of social capital. In order to classify these diverse features, GROOTAERT and BASTELAER (2002, p. 6) draw a methodological distinction between two forms of social capital – structural (established roles, social networks and other social structures) and *cognitive* (shared norms, values, trust, attitudes, and beliefs).

However it seems more appropriate to differentiate between the contents and form, rather than between two kinds of form. In this research, it is accepted that roles, social networks and other structures represent the structural form of social capital, whereas norms, values, trust,

attitudes, and beliefs constitute its contents. *Social capital can therefore be defined as norms, values, and trust embodied in the specific structural forms* (e.g. networks, associations, groups etc.). An insightful comparison is that the network or other structure stands in the same relationship to social capital, as the business firm to physical or financial capital, or the individual to human capital. Contents and form are always inseparable; only in their unity they will be thought to constitute social capital.

## 2.4 The properties of social capital

As the very term suggests, social capital is a concept focused on the socialisation of individual entities, infusing the inter-agent relations with a positive content to the effect that some kind of a positive integrative super-individual structure is formed. To the theoretical discussion of social capital it does not matter whether this structure is embedded in any formal or legal arrangement; the very fact of its existence is the determining factor. This is probably the case with any kind of grass-roots initiative, which exists exactly to the degree that it is socially useful, regardless of whether the current legislation requires such cooperative agreements to be reflected in the official databases.

In view of these circumstances, the essence of social capital can be identified in that it always has a relation to an inter-agent interaction, socialisation, or any other process of imparting a systems quality to individual entities. Therefore an important task in the study of social capital would be to identify its properties that logically follow from its essence and definition. These properties are most usefully analysed in a comparative perspective with respect to physical and human capital, as it was made in a number of studies. COLEMAN indicated that “physical capital is wholly tangible, being embodied in observable material form; human capital is less tangible, being embodied in the skills and knowledge acquired by an individual; social capital is even less tangible, for it is embodied in the *relations* among persons” (1990, p. 304, emphasis in original). GROOTAERT and BASTELAER (2001, p. 7) mention that unlike physical capital but like human capital, social capital can accumulate as a result of its use; although every other form of capital has a potential productive impact in a typical Robinson Crusoe economy, social capital does not. Similarities with other types of capital are also indicated: social capital is not costless to produce and it represents an accumulated stock from which a stream of benefits flow (ibid, pp. 7-8). In PUTNAM’s (2000, p. 19) opinion, human capital refers to individuals whereas social capital refers to connections among individuals and the social networks. OSTROM and AHN (2001, pp. 13-14) discuss four differences between social and physical capital: 1) social capital does not wear out with use but rather with disuse; 2) social capital is not easy to see and measure; 3) social capital is hard to construct through external interventions; 4) national, regional, and local governmental institutions strongly affect the level and type of social capital available to individuals to pursue long-term development efforts.

Other specific features of social capital in relation to physical capital also can be identified.

1. Social capital has a more intermediate role in the achievement of business objectives related to material resources. The more profound instrumentality of social capital is displayed in its facilitating (secondary) role in the creation of wealth, since social capital is primarily associated with the provision of services to ensure the better functioning of some main production unit, while the latter is normally associated with economic capital. The limitation of social capital in this respect is that these services may not always be necessary, and even when they are, this necessity may not be self-evident.

2. Although social capital can be used directly, i.e. not instrumentally, in the straightforward enjoyment of friendly and trustful relations among partners, both within the hierarchies and between them, such consumption will necessarily be of a moral, i.e. non-material character. The moral essence of social capital would make it relatively unattractive for (presumably, most) people who prefer immediate material reward to all possible forms of moral pleasure.
3. An essential feature of social capital is that it is always highly idiosyncratic, i.e. is not freely transferable to other coordinates of space and time. The idiosyncrasy of social capital is expressed in the fact that the available social capital in area A (or situation A) can be transferred to area B (or, respectively, situation B) only at the cost of significant, if not total, sacrifice of its productive value. In other words, all instances of social capital are strongly connected to the local conditions (including both the objective situation and attitudes of people) which gave rise to them.

The next two properties are related to a special relationship between the individual and systems dimensions of social capital (i.e., respectively, possessed by an individual agent and community).

4. The possible amount of individually held social capital is more strongly related to its total amount in the community, than is the case with physical and financial capital, for which this individual/systems relationship is more indefinite. Social capital shows necessarily less inter-agent differentiation with respect to individual endowments.
5. The systems social capital produces atmospheric effects which promote (or impede) the intensity of business activity in the community, while similar effects are not characteristic for physical or financial capital.

A principal characteristic of social capital is its ability to influence the size of transaction costs of business activities in the community. In general, transaction costs arise because of the restricted knowledge and tendency to make errors of real-world decision-makers, who therefore will always function inefficiently relative to the hypothetical decision-makers of neoclassical theory (FURUBOTN and RICHTER 2001, p. 39). However it can be noted that the substantive components of social capital, contained in its above proposed definition (Sec. 2.3), are precisely directed at the attenuation and neutralisation of these human limitations. In this sense, *the general effect of social capital lies in reducing the size of transaction costs*, whatever is the specific area of their expression. In fact, it is the shortage of social capital, that makes the behavioural assumptions of the neoclassical economic models unrealistic. The possession of social capital is thus the basic assumption for neoclassical welfare maximisation.

The generalisation of the preceding argument is proposed in Table 2.

The analysis in Table 2 shows that although social capital may be more difficult to accumulate (in terms of the role for business, possibility of direct consumption, idiosyncrasy), it may have greater benefits for the community. The somewhat problematic role of social capital is conditioned by its relational and intangible nature, compared to the relatively straightforward nature of material and financial wealth. It can be argued that social capital is hard to identify and measure exactly not because of poor intellectual abilities of those who do it, but rather because of the corresponding properties of this capital itself. This is also indicated by the impossibility of any direct indicator, which would reflect the state of this capital, and the emerging need to rely on proxy approaches. The conceptual disputes, appearing in the literature, testify that it is not just the quantity of something already known, that is sought, but the quality of this mysterious entity either. A generalisation of this peculiarity of social capital can be

formulated in terms of its “elusive essence”, which reflects its objective properties and not the cognitive weaknesses of the learning agents.

**Table 2: Comparative analysis of social and physical capital**

Criterion	Social capital	Physical capital
Role for business	More intermediate	More direct
Possibility of direct consumption	Limited	Unlimited
Idiosyncrasy	High	Variable
Inter-agent differentiation	Low	May be high
Atmospheric effects at systems level	Present	Absent
Effect on transaction costs	Reduction of transaction costs	No effect

Source: Own presentation.

The elusive quality of social capital has several important consequences. One of them is that social capital traditionally has not been the focus of purposeful activity of economic agents, but rather as an unintended by-product, as indicated by COLEMAN (1990, p. 317). Second, the attention to it began to appear no sooner than its insufficiency was recognized as a source of difficulties in the economic development or the development of democracy. Third, its two characteristics: 1) elusive essence and 2) failure to function as a target parameter of economic activity by themselves plainly explain the tendency toward its underproduction. In COLEMAN’S (ibid) view, the underproduction tendency can be traced to its public good nature, but this reason seems to be somewhat too narrow in its applicability, since many situations are possible, when the maintaining and strengthening the existing condition of mutual trust is in the direct interest of an agent<sup>5</sup>, whereby the free-riding incentives are effectively attenuated.

Since the inter-agent relational character is the essential feature of social capital, and the possibilities of its construction depend upon the behaviour and attitudes of individual agents, it makes sense to propose that *social capital represents the socialized human capital*. The relationship between human and social capital may be additionally compared to the relationship between the individual and the organisation, or between the firm and the market. Social capital is a set of relations of a given human capital (including intellectual and ethical components) with other human capitals, just like a market is a set of relations between firms. In this context, it would be reasonable to believe that human and social capital are connected just like the firm and the market. We correctly expect a poor performance of organisation and dysfunctions of market mechanism if it is known that, respectively, the individuals and the firms do not perform well. By the same token, we can assume that social capital of a person in certain environment will not be essential if the quality of human capitals (his and others, including intellectual and ethical resources) are low.

<sup>5</sup> To be sure, public good nature is an important consideration. In conditions of a transitional economy, however, the underproduction of social capital is hardly caused by this reason. Agents do not pay for the respective benefits because they are not aware (or do not understand) what needs to be done to improve their situation. Education, advisory and information work are crucial. Public good case, on the contrary, implies that agents would like to obtain the well-known good for free.

## 2.5 The resource allocation role of social capital

The analysis of the proposed concepts of contents, forms, and properties of social capital can reveal a fundamental economic significance of this phenomenon, lying in its ability to effect the allocation of scarce resources in the socially desirable directions. The local grassroots initiatives to build a hospital, an irrigation system, or a school are all examples of attempts at resource allocation, in cases where the traditional allocation mechanisms of markets and hierarchies are not working. In fact, the very reason to provide certain services on a mutual self-help basis is the absence of respective markets and inability of existing hierarchical structures, either business firms or public authorities, to take these tasks upon themselves.

Theoretically, the market can be an inappropriate solution for a resource allocation problem because of two reasons: either the effective demand is missing, because of inability to bear the financial costs of purchase, or there can be no supplier for a particular product or service, most likely due to its significant idiosyncrasy. The hierarchical structure, whether public or private, may not accept the task because of either lack of motivation, or inability to bear the costs, or technical inability to produce the required output. To generalize, the reasons behind the inadequacy of centralized and decentralized price-based resource allocation mechanisms are too high transaction and/or production costs.

While the grassroots initiatives are essential for human progress regardless of the economic condition of the respective society, it can be believed that in poorer nations the major rationale behind the activation of the social capital-based resource allocation mechanism is prohibitively high production costs, while in more developed economies this need is dictated by significant transaction costs. In the first case, the grassroots initiatives are aimed at providing the valuable services to the community members by means of sharing infrastructural facilities and coordinating individual actions (e.g. in marketing); in the second, the initiatives are undertaken to generate the long-term competitive advantages by creating strategic alliances, joint ventures, learning networks, and other inter-organisational arrangements.

All resource allocation mechanisms can function only in the appropriate organisational framework: centralized allocation takes place in hierarchies, decentralized – in markets. Respectively, the social capital-based allocation is effected in the above mentioned networks, inter-organisational ventures, all kinds of grassroots associations, including cooperatives in their diverse forms. Consequently, these structures should be viewed as a distinctly special type of economic organisation, to which the standard tools of organisational economics, in particular transaction cost economics, may not be fully applicable. The special organisational nature of the social capital-based structures will be discussed in sec. 4.

It should be noted that the resource allocation role of social capital is principally different from the respective role of markets and hierarchies, which follows from the differences in purposes that these organisations serve. The purpose of social capital-based organisation is to fully mobilize the potential of private collective action by rendering previously unavailable services to members, which means *to initiate principally new transactions*; in contrast, markets and hierarchies are used *to ensure the efficient governance of on-going transactions*. While the economic problem for conventional organisation is to determine which institutional arrangement (governance structure, order, or constitution) is rational or economically preferable (FURUBOTN and RICHTER 2001, p. 265), the search for the optimal institutional form is largely irrelevant for social capital-based organisation. The problem is rather how to create such an institutional environment, in which the grassroots initiatives freely emerge whenever they are desirable.

Therefore, the resource allocation mechanisms of markets and hierarchies are directed at ensuring that the current structure of production corresponds to a point *on the* production possibility frontier rather *within* it by minimizing governance costs, while the social capital-based resource allocation is aimed at expanding the frontier itself. In this sense it can be said that social capital-based resource allocation is dynamic in that it creates new uses for resources, while the static nature of both centralized and decentralized allocation lies in minimizing transaction costs of maintaining the existing structure of resource use.

The argument in the section can be summarized as follows.

1. The universal and eternal problem of inter-agent relations has acquired particular significance at the present stage of human history in view of the dramatic increase of the power of society to consciously control its own welfare, in comparison to various exogenous forces. Therefore, *the quality of inter-agent relations* (a most general definition of social capital) is considered as a factor of social production, equivalent in importance to physical, financial, and human capital.
2. The existing views of social capital can be classified with respect to whether they relate to its individual, organisational, or community level. These structural levels of social capital are differentially associated with the costs of building it, namely exclusion, lock-in, free riding. The neutralisation of these costs was shown to be possible by developing trust, building a common culture, and promoting inter-agent learning processes, which were considered as the contents of social capital. Since every content requires a (structural) form, the latter was shown to be represented by networks, connections, and other non-hierarchical relationships.
3. Social capital was shown to be more difficult, than physical capital, to build on the individual level, due to its more intermediate role for business, limited possibility of direct consumption, and greater idiosyncrasy. The greater benefits of social capital for the community are rooted in its lower inter-agent differentiation, special atmospheric effects, and the ability to reduce transaction costs.
4. The fundamental economic significance of social capital is explained by its ability to allocate resources for the useful social tasks in cases where the traditional authority-based and price-based resource allocation mechanisms do not work. The social capital-based resource allocation mechanism is different from these traditional mechanisms in that it is aimed to render new, previously unavailable, services rather than to minimize the governance costs of on-going transactions.

### 3 THE TRANSITIONAL CONTEXT

The objective of this section is to examine the significance and implications of the social capital concept for the market transformation of the CEE agriculture. Essential for this objective is the task of ascertaining the relative roles of private collective and governmental action in the transitional process, which is undertaken in sec. 3.1. The specific expressions of the role of social capital for an agrarian reform can be demonstrated through a variety of theoretical approaches, such as political economy (sec. 3.2), property rights approach (sec. 3.3), transaction cost economics (sec.3.4). In all these approaches, the effectiveness of reform processes is shown to depend on the quality of relations among the stakeholders.

### 3.1 The transformation of responsibility

The transitional process in agriculture of the CEECs, regardless of its effectiveness in specific coordinates of space and time, has been characterized by a number of challenges that can be classified into two broad categories. One of them has relevance for the role of the government and local official bodies which were assigned the responsibility for the adequate administering of the reformation procedures. Such issues as quality of implementation, competence of local administrative staff, their ability to organize rural people in a situation of political, economic and legal uncertainty have been the important determinative factors of the reformation efficiency. The other group of transition challenges, the very existence of which went probably completely unnoticed in the initial phases of transition, was the role played by independent and responsible grass-roots decisions. It can be argued that every further phase of transition has proved the more long-term and far-reaching significance of the second group of challenges, in view of the fact that private (grass-roots) motivation and activity is the cornerstone of the market system and serves as the target condition of the reform in political, economic, social and organisational respects.

Despite the very real importance of efforts by the central government and local administrative offices for ensuring the reform success, the decisive role of grassroots activity and proper understanding of its potential effects on the part of agricultural producers and rural residents cannot be denied. In this connection, it is useful to distinguish between the top-down and bottom-up aspects of this transformation of responsibility. In terms of top-down aspect, the government distances itself from the execution of many microeconomic business functions, which had been a prerogative of the state under planned economy. In fact, this process has fundamental significance for transition to market, since the market system is based on the independence of private enterprise in deciding what and how to produce, determining business partners and participating (to the extent of relevant economic power) in establishing the terms of trade.

In terms of bottom-up aspect, this process should be matched by the growing awareness of agricultural producers that increasingly more business decisions are transferred to their terms of reference, and more business functions and services should be rendered on the grassroots basis. This aspect probably explains some negative impacts that the initialisation of the reform procedure had on the availability of important production and marketing services to the producing units. The information and extension activities undertaken by the administrative bodies served to increase this awareness, but the problem lied not so much in the access to information, as in intuitive understanding of the new role of private action, which takes much longer to shape.

This conceptual framework seems to be confirmed by the recently emerged interest in social capital as a factor of transition process.<sup>6</sup> The interest for social capital in this context testifies that some important role of bottom-up factor is recognized. The fact that the concept of social capital, traditionally studied in the context of democracy building and developmental processes, now is examined in the light of the transition process, means that the governmental

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<sup>6</sup> RAISER (1997, p. 26) comes to the conclusion that "a crucial role of informal institutions in all societies is to facilitate economic exchange both by supporting self-enforcing 'rules of the game' and by fostering trust in third part enforcement through the state... trust positively depends on the level of social capital in a given society". Social capital is understood by the author as a set of informal institutions (mainly trust) that facilitates the transition process. RAISER's argument differs from the framework proposed here in that the top-down/bottom-up dichotomy of the transitional process is not explicitly recognized and social capital is associated mainly with the extent to which a society can overcome abusive activities during the market transformation.

bodies must have exhausted their potential of improving the status-quo in agricultural sector, and the appreciation of another resource factor, namely bottom-up (grassroots), started to guide the thinking of those who analyse these developments. In other words, the presence of serious faults in agricultural policy (governmental action) would make the interest in the bottom-up factor of transition too early (Table 3).

**Table 3: The transitional agenda<sup>7</sup>**

Action parameter	Transition stage	
	Initiation	Completion
Subject	Government	People
Object	Formal institutions	Informal institutions
Mechanism	Regulation	Private collective action

Source: Own presentation.

Thus, it is possible to give a more explicit formulation of the challenges to be faced in further stages of the transition process: representing a change in formal and informal institutions with mainly completed formal components, consummation of the market transition process calls for a restructuring of informal rules, norms, values, and ideology, which determine the socio-economic outcomes of transition jointly with formal institutional change factors. The essence of the required informal institutional change is *to create the potential for effective collective action by agricultural producers*.

### 3.2 Social capital and political economy of agrarian reform

According to the political economy approach to agrarian reform, the policy makers and other stakeholders are seen as “rational and maximizing agents who respond to incentives and constraints just like agents in the economy” (SWINNEN 1999, p. 51). The value of this approach can be considered to lie in the pragmatic common sense in analysing the abundant political rhetoric accompanying the respective institutional change (see RABINOWICZ and SWINNEN 1997, p. 15). In this framework, several causal mechanisms can be identified, highlighting the role that social capital can play for improving the outcomes of the reform process. First, the presence of community-level social capital results in the identity of national interests and private objectives of policy-makers and the agents responsible for reform implementation. The national (systems) interests are recognised by respective agents and naturally incorporated into their individual utility functions. Hereby it is assumed that these agents are not only morally prepared to forego certain private gains that are achievable by abusing their authorised competencies, but also adequately understand where the national interests are to be sought. Although it would not be possible to determine, in abstraction of specific examples, whether such social capital can exist, there are no grounds to reject these assumptions *a priori* in view of the presence of various disciplining mechanisms, ranging from individual ethic to political competition.

<sup>7</sup> The table is not intended to contradict the intuitive conception that the whole transition process was triggered by private collective action at the very outset. Rather, it is based on the understanding that the reasons for the transformation resulting from the imperfections of the central planning system have been recognized on the grassroots level before the actual transformational process started. However it is important not to underestimate the role of government in laying the political, legal, and organisational foundations of the transitional process.

Second, the distributional effects of a social capital-supported agrarian reform lose their importance and the economic efficiency becomes the major determinant of policy decisions. The redistributive effects of such a reform are by-products rather than the primary motivations of its initiators. In contrast to the implications of BECKER's and OLSON's models explaining the redistributive transfers by the power differentials of various interest groups, in the social capital-supported social environment these transfers would be 1) accidental and unintended; and 2) compensated either by the government or non-governmental actors. As long as this compensation is possible, the redistributive effects need not be considered as a distorting factor of the reform (see SWINNEN 1999, p. 51). Respectively, their distorting consequences, if any, can be traced back to a condition of low social capital.

### 3.3 Social capital and privatisation of property rights

The establishment of private property rights over agricultural assets is the basic rationale behind agrarian reforms in CEECs. As indicated by RABINOWICZ and SWINNEN, "privatisation in the CEECs has had to do more with the transfer of property rights than with legal ownership rights" (1997, p. 2), since the former include a broad spectrum of competencies related to the rights of consuming, obtaining income from, and alienating the assets. Only to the extent that the whole spectrum of these partial rights can be effectively actualised by new owners, can the privatisation be considered to be successful (although this viewpoint ignores the possibility that the allocation of property rights, initially designed by the reformers, may not have been optimal). The basic message of the property rights approach is that "property rights assignments influence the allocation of resources, the composition of output, the distribution of income" (FURUBOTN and RICHTER 2001, p. 72) and private property rights are known for their most beneficial effects on the economic behaviour and performance.

However, it has become a recognized problem of the CEE agrarian reforms that the private property rights could not always be fully restored. For example, the rights to sell the land could be limited, as was the case in the Baltic countries, or significant transaction costs would be incurred in the assignment of an 'equivalent' or 'comparable' plot of land, as was the case in several CEECs (RABINOWICZ and SWINNEN 1997, p. 2). In Ukraine and Russia, where the institution of co-ownership is widely used to achieve the economies of scale and to preserve the infrastructure, the economic behaviour of individual co-owners is constrained by motivations and decisions of other co-owners, in which case the respective private property rights again cannot be fully actualised. The general observation is that the effectiveness of newly established property rights depends on the effectiveness of certain forms of collective action and consequently – on the quality of inter-personal relations. This is where the concept of social capital enters the property rights interpretation of an agrarian reform: the availability of social capital affects the extent to which any given configuration of property rights can be actualised.

Thus, the property rights approach can be conceptually expanded by recognising that social capital influences the ways in which the assignment of property rights influence the allocation of resources and that any given assignment can result in different allocations depending upon how much social capital is available in the community. This conclusion directly follows from the analysis of co-ownership, but it also has a more general and more important significance, in that social capital facilitates the creation of informal networks, which in turn lead to the establishment of effective, rather than only legal, markets. The presence of such informally supported markets is in fact the major factor in making private property rights full and complete. This is one of the specific instances of the general principle that the formal institutional change should always be supplemented by a change in the respective informal institutions.

### **3.4 Social capital and transaction costs of market transformation**

An obvious and important fact about the agrarian reform in practically every CEE country is that this process could never be organised in strict accordance to what had been originally planned or designed. These deviations can always be traced back to the inherent characteristics of human nature – bounded rationality and opportunism – the explicit recognition of which is a starting point of transaction cost reasoning. In combination with the extraordinary complexity of transitional institutional change, these human limitations result in the emergence of transaction costs of market transformation, which as a rule were not originally taken into account and adversely affected the reform outcomes.

In a general sense, transaction costs of market transformation arise because the designed institutional basis of transformation is not adequately supported by the quality of inter-personal relations, comprising such parameters as ethics, ability to understand the essence of reform, and access to information. According to RABINOWICZ and SWINNEN (1997, pp. 5-6), with positive transaction costs in land and assets markets, the transformation process is affected by the privatisation process in the direction that higher transaction costs enhance the ability of the current management to reorganize the farm according to its own preferences. Therefore, transaction costs of market transformation are expressed in the dominance of distributional motivations of reform actors over efficiency-improving ones, in the perfunctory attitudes toward reform implementation, in the wrong decisions regarding privatisation and decollectivisation policies, and in the lack of information about and understanding of the essence of reform. BECKMANN and HAGEDORN (1994, p. 150) draw attention to how transaction costs of transformation influence the choice of new organisational forms, whereby the formation of agricultural producer cooperative serves to economise on these costs, in spite of its alleged incentive deficiencies.

At the same time, as it is known from Sec. 2.4, the availability of social capital serves to reduce transaction costs regardless of their specific form of expression. In the case of agrarian reform, social capital results in deeper substantiation of the reform policies, greater transparency of transformational procedures, more responsible implementation attitudes, greater collective self-consciousness of reform stakeholders and consequently lower opportunism. The retrospective conclusion from the transaction cost view of market transformation is the necessity of estimating the potential transaction costs of planned formal institutional change against the available stock of social capital by designing more coordinated implementation mechanisms (here conceptually analogous to ‘governance structures’).

The argument in the section can be summarized as follows:

1. The success of transitional process was shown to be dependent on the efficiency of both top-down (governmental) and bottom-up (grass-roots) action, with the latter becoming particularly important when the necessary political, legal and organisational reforms, depending upon the governmental action, had been effected. Because of this transformation of responsibility from top-down to bottom-up organisational approaches, possession of social capital was shown to be a critical determinant of socio-economic welfare of rural communities which went through the transition.
2. The role of social capital for the effectiveness of an agrarian reform has been demonstrated from a variety of theoretical approaches to studying the reform processes. In particular, from a political economy viewpoint, social capital results in the identity of national interests and private objectives of policy-makers and agents responsible for reform implementation, as well as the dominance of efficiency-improving behavioural motives over distributional ones.

3. The application of the property rights approach suggests that social capital affects the ways in which the assignment of property rights influence the allocation of resources and that any given assignment can result in different allocations depending upon how much social capital is available in the community.
4. In transaction cost economics perspective, social capital serves to reduce the transaction costs of market transformation, which results in deeper substantiation of the reform policies, greater transparency of transformational procedures, more responsible implementation attitudes, greater collective self-consciousness of reform stakeholders and consequently lower opportunism.

#### **4 SOCIAL CAPITAL AND ECONOMIC ORGANISATION**

In view of its central focus on the quality of inter-agent relations, the implications of the social capital concept for the organisation of economic activity must be far-reaching. The general framework of organisational implications of social capital is outlined in Sec. 4.1. Some of these implications are analyzed in greater detail in the following sections. In particular, the nature and mechanisms of the social capital dependence of different organisational forms common for transitional agriculture of CEECs is ascertained in Sec. 4.2. The attributes of the mutual self-help arrangements, as embodiments of social capital-based organisation, are studied in Sec. 4.3. The explanation of the special significance of grassroots initiatives for (transitional) agriculture is the object of Sec. 4.4.

##### **4.1 The organisational role of social capital**

The concept of social capital cannot be fully understood without analysing its implications for the organisation of economic activities. The following basic determinants can be identified that shape the organisational framework of an economy: 1) the macroinstitutional environment, prescribing the set of available organisational options; 2) the technical nature of the business; and 3) the behavioural patterns of economic agents. In conditions when the macroinstitutional environment is relatively fixed and allows a choice from a spectrum of forms ranging from arms-length market contracts to hierarchy, the optimal behavioural structure will depend on the combination of behavioural patterns and technical nature of transactions involved, which is reflected in the main hypothesis of transaction cost economics: “transactions, which differ in their attributes, are assigned to governance structures, which differ in their costs and competencies, in a discriminating – mainly transaction cost economizing – way” (WILLIAMSON 1996, p. 59).

While social capital obviously cannot affect the technical nature of transactions, it can change the respective transaction costs by improving the behavioural patterns of economic agents. As follows from our definition of social capital (Sec. 2.3), its accumulation and actualisation are associated with building trust, facilitating learning processes and developing commonly shared sets of cultural rules. From here, three consequences for the economic organisation come to mind:

1. The resulting reduction of transaction costs would favourably effect all organisational structures by enhancing their potential for adaptability for all kinds of hazardous situations. The reverse is also true: shortage of social capital would subject any structure to additional stress. In a case where different types of structures exhibit different degrees of dependence on social capital, such stresses would result in the organisational restructuring.

2. Another consequence is that the operation of social capital would alleviate the hold-up problem and transactions involving significant asset specificities or any other idiosyncrasies would not require highly coordinated governance structures. Greater trust and better mutual knowledge of the situation would make more informal governance sufficient.
3. Since the amount of social capital in the community is directly proportional to and responsible for the intensity of grassroots activities in the sense of PUTNAM (1993), all kinds of mutual self-help arrangements represent the social capital-based organisation, which is distinct from both market and hierarchical organisational modes. The mutual self-help is the organisational device for social capital-based resource allocation mechanism, discussed in Sec. 2.5.

The relationship between the organisational implications of social capital and transaction cost reasoning can be summarized as follows. While there is a fundamental similarity between them in adhering to the above-mentioned central hypothesis, social capital presupposes a different (more positive) set of behavioural assumptions. The availability of social capital means that the problems of opportunism and bounded rationality<sup>8</sup> are much less severe, which attenuates the need for a more coordinated governance of otherwise risky transactions.

#### 4.2 Social capital dependence of organisational forms

The motivation to ascertain the differential association of different organisation forms with social capital stems from the fact that the respective incentive structures presuppose different types of inter-agent relations. It can be argued that the presence of social capital is a major requirement for the creation and maintenance of organisational forms with an important role of informal structure, which is particularly the case with member-oriented organisations. As was established in the previous section, in some situations the informal structure is so strong that the formal one loses its significance: those transactions, for which transaction cost reasoning suggests more coordinated governance, can be governed in a more autonomous framework, if the relation between partners is supported by the required social capital. In this way, social capital facilitates the preservation of high-powered incentives by neutralizing their disadvantages related to opportunistic behaviour.

It is possible to identify three major aspects of the quality of inter-agent relations, which are decisive for determining the general dependence of an organisational form on social capital: 1) ability to achieve the internal consensus; 2) trust among members; and 3) the intensity of agency problems (here understood as related to trust between members and employees). The relative importance of these aspects for various organisation forms is directly proportional to their relative dependence on social capital. A simple comparative analysis of organisational forms, most common in CEE agriculture, is attempted in Table 4.

The meaning of the dependence of the organisational form on social capital is that *the enterprise cannot be effectively created and maintained unless it is supported by the required amount of social capital*. In this sense, as follows from the table, the agricultural producer cooperative (APC) is the most social capital dependent form. Its very creation requires the reaching of a consensual decision by a group of agricultural entrepreneurs; its continued operation also crucially depends on the extent to which APC members continue to be mutually trustful, knowledgeable, sharing the same set of basic values, and adhering to common rules.

<sup>8</sup> Bounded rationality is reduced by improved communication and better information flows between people sharing social capital.

**Table 4: Social capital dependence of various organisational forms**

<b>Orga- nisa- tional form</b>	<b>Aspects of inter-agent relation quality</b>			<b>Com- parative depend- ence on social capital</b>
	<b>Achievement of internal consen- sus</b>	<b>Intensity of agency problems</b>	<b>Importance of trust among members</b>	
<b>Agricul- tural pro- ducer co- operative</b>	Complicated due to democratic decision making	Significant due to twofold nature of agency problem (agents as principals and principals as agents (SCHMITT 1993, p. 154-155))	Trust is essential for creation and normal functioning of these organisations	Very high
<b>Service coopera- tive</b>	Complicated due to democratic decision making	Standard agency relation between employees and members	Trust is essential for creation and normal functioning of these organisations	High
<b>Limited partner- ship</b>	Not a significant problem under hierarchical decision making	Standard agency relation between employees and members	Trust is essential, although members may occupy a minor share in the quantity of stakeholders	Medium
<b>Joint stock company</b>	Not a significant problem under hierarchical decision making	Standard agency relation between employees and members	Trust is not essential	Low
<b>Family farm</b>	Not a significant problem	No agency relations (in conditions of no hired labour)	Trust exists <i>a priori</i> due to family connections	Practically no dependence

Source: Own presentation.

The high social capital dependence of APCs is expressed in relatively high transaction costs of their internal governance because of collective decision making and inappropriate incentive structure regarding work effort and management (see e.g. SCHMITT 1993, BECKMANN 1993). The following inefficiencies of APCs were detected: 1) the co-determination rights of members result in inefficient decisions leading to lower managerial flexibility and controversies between members' interests as agents and as principals; 2) APC is beset by agency problems in that the management is likely to pursue its own objectives at the expense of members' interests; 3) monitoring of hired labour is also costly.

On the other hand, however, the social capital dependence means that transaction costs of collective decision making and incentive structures of work effort and management depend upon the availability of social capital. The possession of significant social capital can reduce these costs and optimise the incentive mechanisms, with the result that the transaction cost parameters of APCs may approach those of family farms. Although the possession of social capital does not run counter to the expediency of family farming, it can make agricultural co-operation cheaper in transaction cost terms. Therefore, the conclusion from the transaction cost view of organisational development of agriculture is that its trends will be determined not only by comparative transaction cost parameters of different enterprise forms, but also by the available stocks of social capital.

### 4.3 The concept of social capital-based organisation

As established in Sec. 4.1, one organisational implication of social capital is that it gives rise to the emergence of a special type of organisation structures, which can be attributed neither to hierarchical nor to market organisational modes. The social capital-based organisation is represented by the mutual self-help arrangements in the great diversity of their forms, ranging from local informal groups to regional and national associations and political parties. Regardless of their legal status, size, and functional scope, their objective is to articulate, protect, and promote the interests of members who founded it. Remembering that the proposed above definition of social capital (Sec. 2.3) differentiates between its contents and form, the mutual self-help arrangements can be considered to be the form, within which the substantive components of social capital are actualized. It can be said that these components – norms, values, trust – stand in the same relation to the mutual self-help arrangement, as the authority relation with respect to the hierarchy or the price with respect to the market mechanism. A generalisation of the features of centralized, decentralized and social capital-based organisation is attempted in Table 5.

The general rationale behind the existence of the social capital-based organisation is that there are certain useful social functions that cannot be effectively delivered both by hierarchies and markets but rather require different resource allocation mechanisms provided by social capital. Naturally, the creation of such organisations critically depends on the availability of social capital, which can in this way improve the welfare of respective communities.

A characteristic representative of the social capital-based organisation is the cooperative (regardless of the type of its activity), due to its member-oriented nature. An interesting transaction cost analysis of the cooperative organisational form is provided by BONUS (1986), who explained it as a protective institution designed by agents (members) to prevent the extraction of quasi-rents from them by their partners, for whom they developed a transaction-specific dependency. Although this explanation can be correct for the situations, referred to by the author, it is limited only to cases where transaction-specific quasi-rents exist and require protection efforts. At the same time, many situations are imaginable, when this would not be a major rationale behind the establishment of a cooperative. Cooperatives can be created to economize on the purchasing and selling costs, provide a valuable technical service to members (unavailable from any other partner), or to achieve economies of scale in using the large-scale production facilities, which would not be worthwhile for an individual member.

**Table 5: Comparative analysis of organisational modes**

Criterion	Organisational mode		
	Centralized	Decentralised	SC-based

<b>Governance orientation</b>	Top down	Horizontal (mutual)	Bottom up
<b>Basic motive</b>	Salary / promotion	Profit	Mutual self-help
<b>Importance of inter-personal relations</b>	Non-critical	Non-critical	Critical
<b>Resource allocation mechanism</b>	Authority relation	Price	Norms, values, trust
<b>Structural form</b>	Hierarchy	Market <sup>9</sup>	Cooperatives, networks, alliances, etc.

Source: Own presentation.

In comparison to the organisational arrangements analysed by transaction cost economics (markets, hybrids, hierarchies), the social capital-based organisation has two distinctive properties:

1. The behavioural assumptions are not confined to limiting (negative) cases of bounded rationality and opportunism. Various degrees of trust, adherence to common culture, and learning efficiency are assumed.
2. As discussed in Sec. 2.5, the social capital-based organisation serves the purpose of expanding the production possibility frontier. While the objective of conventional markets, hybrids, hierarchies is to find the most cost-effective governance of transactions, social capital structures are intended to create new production alternatives and expand the set of economic opportunities rather than to economize on transaction costs.

There is nothing impossible about a situation when transactions among a given set of agents are optimally governed across markets and hierarchies, while certain opportunities of mutual self-help (and hence, welfare maximisation) are not utilized. Thus, the social capital approach to economic organisation requires that not only the existing (on-going) transactions should be efficiently governed, but the governance structures should make way for the emergence of qualitatively new transactions, related to providing the valuable services to agents.

#### 4.4 The social capital-based organisation in agriculture

It is common knowledge that the mutual self-help arrangements have been traditionally important for agriculture, where they are represented by informal mutual self-help groups, producer cooperatives, service cooperatives, purchasing and marketing cooperatives of centralized and federated types, and diverse farmer associations including agrarian political parties. Although the specific organisations of the listed types can be quite heterogeneous, they all have in common their member-oriented nature, bottom-up governance, high dependence on the quality of inter-personal relation among members, first of all trust. In developed economies, the purchasing, marketing, and credit cooperatives, farmer associations and political parties play important roles in the regulation of agricultural markets and the political protection of farmers' interests, while in transitional agriculture particularly advantageous can be informal self-help groups, producer cooperatives, service and marketing cooperatives.

<sup>9</sup> The following definition of market as a structural form of decentralized organisation seems appropriate: a network of (more or less) relational contracts among individuals who are potential buyers and sellers (FURUBOTN and RICHTER 2001, p. 273)

It can be hypothesized that the special importance of the social capital-based organisation for agriculture is caused by the special role of agriculture in the market economy. The structural development of agribusiness has led to the growing market power of input and output industries, increasingly characterized by monopolistic and oligopolistic market structures, which deteriorated the terms of trade for the more competitively structured agriculture. Other limitations of agriculture include: inelastic demand for agricultural products and inputs; dependence upon stochastic biological and climatic factors (see e.g. SEITZ ET AL. 1994); high asset specificity which impedes resource mobility out of agriculture (see HATHAWAY 1963); the significant length of production cycle etc. In fact, these factors explain the necessity of devotion of a special area of the socio-economic policy to agriculture (agricultural policy). A general consequence of these industry-specific limitations of agriculture is the disparity of inter-industrial relations, expressed in the lower profitability of agriculture in comparison to input and output industries, which has been the case with practically every transitional CEE economy.

Theoretically the reasons behind the disparity of inter-industrial relations can be incorporated into the methodological framework of the analysis of organisational effectiveness of agriculture by stating that the agricultural firm is organisationally inferior to the firm engaged in other activities. Logically, the economic organisation can be thought of as certain synthesis of structures and functions. Since in the case of agriculture, the combination of market and hierarchical relations results in the deficit of certain vital business functions, such as product marketing, access to credit, input supply, it follows from here that the new structural levels of organisation should be created that specialise on delivering the lacking functions. Since both centralised and decentralised structures are not effective in delivering these functions, such structural levels can be established on the social capital basis and will serve to harmonise the conflicting interests in the agri-food chain and to enhance the competitive power of agricultural producers.

As a rule, the theoretical studies of the future organisation of the CEE agriculture are focused primarily on authority-based structures and should therefore also take into account the potential role that can be played by social capital-based organisation, since its operation can improve the performance of whatever structures already exist and, thus, possibly help to economise on reorganisation costs. The general conclusion is that social capital-based structures can perform a welfare-improving function for the rural communities and should be an integral part of the future organisational model of CEE agriculture.

The arguments in the section can be summarized as follows:

1. The significance of social capital for the economic organisation stems from the fact that the quality of inter-agent relations, expressed in the presence of trust, learning, and culture, affects the ways in which the economic activity is organized. Two implications of social capital for the traditional organisational types of markets and hierarchies seem most important:
  - Different organisational forms presuppose different levels of the quality of inter-agent relations. Organisations requiring high quality of these relations are heavily social capital dependent and can effectively function only when the required social capital is available.
  - Since the availability of social capital in the community reduces the transaction costs of market governance, transactions involving high asset specificities and other idiosyncrasies would not require highly coordinated governance structures. Informal governance would be sufficient.

2. However, the organisational implications of social capital are not limited to the traditional organisational types of markets, hybrids, and hierarchies. The social capital-based organisation is represented by the mutual self-help arrangements in the great diversity of their forms, ranging from local informal groups to regional and national associations and political parties. Their objective is to articulate, protect, and promote the interests of members who founded it.
3. The social capital-based organisation has been traditionally important for agriculture, where it is represented by local informal self-help groups, all kinds of cooperatives, and farmer associations. The importance of the social capital-based organisation can be explained by the relatively insignificant market power of agricultural producers with respect to their market partners. The effective transition to market in agriculture should create the possibilities for the functioning of the social capital-based organisations which usually play an important role in streamlining the development of this sector in a market economy.

## 5 THE POLICY SIGNIFICANCE OF SOCIAL CAPITAL

The most general policy conclusion of the preceding discussion would be that the relative decision-making burden on governmental and grass-roots action in the transitional process becomes increasingly tilted toward the latter. It is now up to the rank-and-file of rural community to raise to an appreciation of their self-organisational potential in solving their own problems. The self-organisation forms are very diverse, ranging from informal mutual self-help agreements to political parties, including intermediate forms of commodity, regional, and functional associations. Another area of collective action should embrace inter-industrial associations, including vertical coordination. The inter-industrial action may require even a greater degree of collective self-consciousness, since it is based on the recognition by non-agricultural agents, staying in a more advantageous competitive position, of the necessity of helping agricultural producers to overcome their industry-specific limitations. Both agricultural and inter-industrial associations are essential to ensure the democratic governance structure of the agri-food sector.

The increasing responsibility of the grass-roots activities is accounted for by two considerations concerning the formal regulation of agri-food sector. First, this regulation may have an 'invisible dimension', related to its not self-evident (and unintended) effect on the informal institutional structure. In this connection it is always important to keep track of what incentives are promoted by every act of regulation and the comprehensive sets of those acts. In other words, the implications of policy action for the grass-roots motivational mechanisms and informal institutions should be taken into account when planning a policy intervention.

Second, an important area of activity should be recognized that falls principally outside of the functional range of regulatory activity, namely an area related to building the conducive inter-agent relations. Although being a crucial part of the overall organisational framework of agri-food sector, under conditions of market economy it cannot and should not (for principal considerations) be directly subjected to the regulatory discretion. The effective inter-agent relations are grounded on the grass-roots effects of building and maintaining the components of social capital: learning, trust, and culture.

It follows from here that the costs of governmental intervention should include, besides the conventional costs of bureaucratic governance, the opportunity costs of foregoing the grass-

roots involvement and undermining for this reason the grass-roots potential for the future.<sup>10</sup> On the contrary, policy should be directed at the maximal mobilisation of this potential, and the account of the existing social capital should precede the planning of government involvement. Rather than solving the task that could be alternatively solved by the self-organisational action, the government should invest in social capital to enable the community to strengthen the self-governance mechanisms on the trust and culture basis.<sup>11</sup> The sheer financial support is applicable only in extreme cases, where social capital can be safely assumed to be zero. As a general rule, a combination of economic and social capital support measures should be observed, with an increasing accent on the latter.

In view of the above circumstances, the general effect of policy intervention should be to minimize the costs of private collective action rather than to attempt to substitute it. Government efforts should be directed to building the infrastructure which would reduce the costs of economic, political, and social self-organisation of agricultural producers. The infrastructural role of the government could be realized by the following ways:

1. maximum delegation of decision-making prerogatives to the grass-roots level, as the growing self-recognition of communal responsibility encourages the development of social capital-based components;
2. creating an effective infrastructure, whereby the agents on all levels – intra- and inter-organisational and inter-industrial – have better chances of reaching consensual positions through an access to a favourable interaction environment;
3. dissemination of information about the true potential of grass-roots organisation, based on the social capital components, in resolving the emerging problems of rural communities;
4. acceptance of initiative positions in creating the atmosphere of trust<sup>12</sup>.

The relationship between economic and social capital acquires a special significance in the context of the structure of agricultural policy. It can be argued that various policy actions can be classified as relating either to economic or social capital of agriculture, with conventional price and income support programs pertaining obviously to the first type. It is intuitively clear that the most effective policy would have an equal emphasis on both types, since marginal efficiency of both economic and social capital-related actions is decreasing, and the strongest effect would be achieved when the efficiencies of these two types of actions are equated at the margin. Therefore, it can be argued that social capital is acquiring a significant political role, which is expressed in the growing recognition of the advantages of the second pillar approaches in the Common Agricultural Policy of the European Union: the direct object and basis of the second pillar policies is not the agricultural production process, but rather rural areas and communities.

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<sup>10</sup> It is commonly recognized that failure to use the grass-roots potential results in its degradation (a distinction from physical capital) (OSTROM and AHN 2001).

<sup>11</sup> In the literature, examples are cited where government interference had a destructive effects on the existing social capital, because it was not taken into consideration at the policy development stage (see e.g. OSTROM 1997).

<sup>12</sup> The trust building process among several agents will require the investment in costly credible commitments and/or acceptance of increased risk by an agent who makes the first step. It would be a very appropriate role for the government to accept these costs. This task is especially important if the government itself is not sufficiently trusted by people and initiative position of the government in building a trust-based relation becomes a necessity.

In fact, in the developed countries the price and income support programs are no longer regarded as a strategic method of solving the inter-industrial disparity problem, partly because of the growing share of the off-farm incomes and deeper vertical coordination, including contract farming. The other areas of policy, directed at equalizing the relative economic and social capital constraints, received a stronger impetus: enhancement of infrastructure, stimulation of rural business, creation of pleasurable living conditions (landscapes, natural amenities), environmental protection (with financial benefits for farmers), food and nutrition policy, research and extension.

The significant level of social capital would allow agricultural producers to be engaged in the self-organized collective action (grass-roots activities), which provides a superior substitute for the direct governmental regulation. As discussed in Sec. 4.2, the organisational forms of such actions are cooperatives and farmer organisations. Vertical coordination is another area of action which can reduce the need for direct regulation, because non-agricultural agents, which are often in structurally advantageous position in relation to agriculture, will regard the latter as part of their own production complex, which means that inter-industrial relations will be harmonized on the basis of self-regulation.

## **6 A REMARK ON THE NORMATIVE IMPLICATIONS OF SOCIAL CAPITAL**

Social capital is undoubtedly a very special type of capital since it is more directly associated with social virtues like trust, knowledge, and culture. This fact raises the question of normative implications – is social capital an end in itself or only an instrument to achieve other goals of society? A related question is whether the concept of social capital contains anything new in comparison to the more general concepts of solidarity and cooperation. The general novelty (and relevance) of the concept of social capital seems to lie in the consideration of the quality of inter-agent relations as a factor of productive activity, just physical, natural and human capital. It should be emphasized that although trust had been known before to be useful, it was not seen in such an explicitly instrumental context. It does not mean, however, that the instrumental quality of trust is impossible. On the contrary, the essence of trust and its socio-economic role is more fully realized when it works both as a means and an end.

In general, the means-ends relation is a dialectical one in that these categories change places in different situations. However, while trust in general can be both an end and a means, social capital just like any other productive factor should always be instrumental. From this follows, that while in some situations, when trust is an end, more of it can be said to be better than less, the same normative approach cannot be applied to social capital. In particular, from the fact that some organisational forms are more social capital dependent than others, it does not follow that the former or latter are better. To be sure, there is a certain controversy in that trust by itself is not necessarily a means, while within the social capital framework it is only instrumental. It should be pointed out that this controversy is not of logical kind, which would render the argument internally inconsistent, but rather dialectical, which reflects the complexities of socio-economic reality. The complexity in this case is that trust and social capital are partially overlapping concepts: each is a part of the other.

It can be summarized that the normative applications are associated with ends but not means and, thus, are incompatible with the instrumental nature of social capital. Although farmers associations and cooperatives require more social capital than individual farms it does not mean that they are better or worse. It also does not mean that the higher number of social capital-based organisations is better than the lower number of them or that all economic organisation of agriculture should be social capital-based. This type of organisation is instrumentally

supplementing the authority-based type to the extent that it is required by the sector-specific limitations of agriculture.

A concise statement of the argument in this paper is that the quality of inter-agent relations is an increasingly important determinant of agricultural development, related to both regular business activities and institutional changes such as market transformation, which means that the sources of improving their efficiency should be increasingly sought in social capital rather than in more conventional factors.

## 7 CONCLUSIONS

The motivation to study the transitional institutional change from the perspective of social capital stems from the general significance of social capital for achieving positive outcomes of socio-economic development. The relevance of social capital for transitional processes in CEECs is explained by the importance of ensuring informal institutional changes, together with the formal ones, especially with regard to growing roles of individual responsibility, informal relations, and bottom-up initiatives. However, applying the social capital perspective for understanding the transitional processes requires answering a range of conceptual questions concerning the role of social capital for agrarian reforms in general and the organisational transformation of agricultural enterprises in particular. The methodological approaches to defining social capital, in view of their plurality, also need to be critically re-examined. The main results of this theoretical inquiry are summarised below.

1. The progress of human society results in the growing power of the conscious deliberate decision-making of societies in solving their problems. The further they develop, the more tools and mechanisms are available to them to organize the social action appropriately. In this perspective, the emergence of interest in social capital is a self-explaining fact: it testifies that the inter-agent relations have grown so complex that major resources of socio-economic development should be sought in them, rather than in technological or natural spheres.
2. Social capital can therefore be defined as norms, values, and trust embodied in the specific structural forms (e.g. networks, associations, groups etc.). Three structural levels of social capital can be distinguished: individual; organisational; community-level. Depending upon the level, the costs of social capital may include exclusion, organisational lock-in, free-riding, and the benefits may include the privileged access to prestigious connections, positive network externalities, and general cooperative spill-over effects. Social capital has been shown to be more difficult to build than economic capital, and to have greater beneficial effects for the community as a whole.
3. The transitional process has been featured by the increasing responsibility of private collective action and grass-roots decisions in managing the business activities in agriculture, since this is required by the democratic foundations of the market economy. In this situation, social capital as the potential of collective action comes to the fore. The different aspects of the role of social capital in the transitional context can be shown from a variety of theoretical approaches to studying agrarian reform, e.g. political economy perspective, property rights approach, transaction cost economics.
4. The quality of inter-agent relations, expressed in the presence of trust, learning, and culture, strongly affects the ways in which economic activity is organized. Organisations requiring high quality of inter-agent relations are heavily social capital dependent and can effectively function only when the required social capital is available. Agricultural cooperatives are an example.

5. The social capital-based organisation is clearly distinct from both markets and hierarchies and is represented by the mutual self-help arrangements in their diverse forms, ranging from local informal groups to regional and national associations and political parties. Their objective is to articulate, protect, and promote the interests of members who founded it.
6. The social capital-based organisation has been traditionally important for agriculture, which can be explained by the relatively insignificant market power of agricultural producers with respect to their market partners. The effective transition to market in agriculture should create the possibilities for the functioning of the social capital-based organisations which play an important role in streamlining the development of this sector in a market economy.
7. The optimal role of the government is to invest in social capital in order to enable rural communities to solve their problems by means of private collective action (self-organisation), rather than to attempt to substitute the latter. The most effective policy would have an equal emphasis on both economic and social types of capital. Since marginal efficiency of both economic and social capital-related actions is decreasing, the strongest effect would be achieved when their relative efficiencies are equated at the margin.

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